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Students to repay Sallie Mae starting in school

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NEW YORK - The running joke about student loans: Don't ever graduate, since you don't have to start paying them back until you do. Starting Monday, that will no longer be the case for students borrowing from Sallie Mae, the nation's largest private student lender.

The company, formally known as SLM Corp., is replacing its signature loan with a shorter-term version that requires students to make interest payments while in school. For many families, the move is expected to push private loans out of reach in an already tight credit market.

The upside is that the cost of a private student loan will be cut by about 40 percent, said Jack Hewes, chief lending officer for Sallie Mae, based in Reston, Va.

Families would repay loans between five and 15 years, compared with the previous 15 to 30 years. Despite the shorter term, Sallie Mae says the monthly bills upon graduation wouldn't rise dramatically.

This is because the interest payments students make while in school would avoid negative amortization, in which the loan balance grows because of deferred interest.

The loans will be available for the 2009-2010 calendar year.

As an example of how the loans will work, Sallie Mae paints the scenario of a student who wants to borrow \$17,000 over two years.

For the first semester of the freshman year, the student would pay \$40 a month. The amount would rise each semester, to \$160 by the second semester of the sophomore year. The \$160 monthly payments would continue until graduation.

Once out of school, the student would owe only the principal of \$17,000.

This would be paid off over the next six years at \$328 a month. Under the previous setup, the student would have repaid the money over 15 years at \$250 a month.

The new requirement will lower the total cost of the loan to \$28,000, compared to the previous \$45,000.

For Sallie Mae, the impetus for the change is easy to see. Interest payments from students while they're in school improve cash flow for the company, noted Mark Kantrowitz, publisher of FinAid.org, which tracks the college financial aid industry. The loans are also less risky, because families that can't pay while in school are weeded out.

Sallie Mae expects its default rate will drop substantially as a result of the change, Hewes said.

In the last fiscal quarter, 4.5 percent of the company's private student loans defaulted.